PKP Intercity S.A. (/gws/en/esp/issr/92020305)

FitchRatings

Fitch Affirms PKP Intercity at 'BBB+'; Outlook Stable

Fitch Ratings-Warsaw/London-19 March 2018: Fitch Ratings has affirmed PKP Intercity S.A.'s (PKPIC) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BBB+'. Simultaneously, Fitch has affirmed the National Long-Term Rating at 'AA(pol)'. The Outlooks are Stable.

Under its Government-Related Entities Criteria, Fitch views that the ability and willingness to provide support by PKPIC's ultimate owner, the Polish state (A-/Stable/F1+), is high. Using a top-down approach and our assessment of four factors under the strength of linkage and incentive to support by the ultimate owner the agency notches down PKPIC's IDRs once from those of Poland.

KEY RATING DRIVERS

Status, Ownership and Control - Assessed As Very Strong:

The company's ultimate parent is the Polish state. It indirectly owns 100% of PKPIC through the wholly state-owned company Polskie Koleje Panstwowe S.A. (PKPSA; BBB+/Stable), which is PKPIC's sole direct owner. PKPIC's legal regime is determined by law approved by the Polish parliament, and as such the company is excluded from the commercial bankruptcy regime and may only be resolved by national law. In Fitch's view, this would likely entail an unconditional transfer of all its assets and liabilities to the state, or to another public entity designated by the state.

PKPIC is mandated by the state treasury to fulfil the central government's national railway strategy in operating interregional and international passenger railway. Through PKPSA the state exerts significant influence over PKPIC. It approves its strategy, investment and funding plans, appoints and dismisses members of the company's management board and controls its daily performance. Management and the supervisory board regularly report on the company's finances to the government.

Support Track Record and Expectations - Assessed As Very Strong:

The bulk of PKPIC's transport performance is generated by the interregional (75% of total passenger train-km in 2017) and international (5% in 2017) services, which is partially loss making. The government has public service contracts signed with the company and pays it compensation for the unprofitable routes. Additionally, it ensures the company a reasonable profit (as per the EU Regulation (EC) No 1370/2007 of the European Parliament). The public service contracts are valid until February 2021 with an option to be prolonged by five years until 2026.

The monthly compensation payments made from the state budget to PKPIC are state grants and must be approved in the state budget annually. The revenue from the contracts provides PKPIC with a stable revenue stream. In 2017, the company received PLN557 million or 21% of total turnover (2016: PLN538 million or 22%) from the state budget, which was sufficient to ensure it a reasonable profit. In 2018-2019 PKPIC expects compensation payments of about PLN570 million annually on average.

The state supported the company in its large investment programme that concluded in 2015. PKPIC received a large equity injection from its direct owner PKPSA to be used for investment finance. From the PLN1 billion injection earmarked at financing investments, the company had still PLN840 million left at end-2017. This will be used for the company's new investment plans.

PKPIC has a large capex plan for 2018-2023 totalling PLN7.8 billion. It foresees the purchase of new rolling stock (PLN4 billion), modernisation of existing engines and carriages (PLN2.8 billion) and other smaller investments (about PLN1 billion). The company plans to fund it with debt (56% of total investment costs), own sources (34%) and EU funds. The programme is vital for PKPIC and we expect that after completion it should result in better network performance, allowing the company to compete more successfully not only in the domestic market, but also on cross-border connections. However, the investments need to be approved by the state and its start is subject to fund availability. We assume that the state will support the company's new investment plan, but at this stage it is too early to determine in which way.

The large investment programme concluded in 2013-2015 (PLN4 billion) was strongly supported by the state. Besides the equity injection of PLN1 billion, the state issued guarantees as collateral for the company's investment loans with the European Investment Bank. At end-2017, debt amounted to PLN2.5 billion and was 67% state-guaranteed. We expect this share to rise to about 80% by 2020, driven by faster redemption of non-guaranteed debt unless the company decides to raise new unguaranteed debt that may dilute the share.

Socio-Political Implications of a GRE's Default- Assessed As Moderate:
Fitch believes that PKPIC's financial default would not materially affect provision of service although it may prove difficult to substitute train service in the short to medium term. The company has a dominating market share (51.1% market share

as per passenger-km in 2017) in the railway sector, but its services could be substituted by other means of transport (planes, busses and cars).

Financial Implications of a GRE's Default - Assessed As Strong:
A default of PKPIC could lead to reputational risk for the Polish state. PKPIC, its owner PKPSA and the state treasury tap domestic and international capital markets for debt funding, as well as use loans from the IFIs, so any potential default of the former could to some extent influence the cost of funds for future debt financing of other government related entities or the state treasury.

This assessment under the Government-Related Entities criteria leads to a one-notch discrepancy from the sovereign's IDRs, irrespective of the standalone credit assessment.

Standalone Credit Profile:
PKPIC's debt continued its declining trend to PLN2.5 billion at end-2017 from PLN2.7 billion at end-2016. However, due to new investments, we expect PKPIC's debt to return to growth in 2019 but do not exceed PLN2.9 billion (peak at end-2015). Despite the debt growth, we project that net-debt-to-EBITDA will not exceed 5x-6x in the medium term (2017: preliminary 2x). Debt service will be smooth in 2018-2020, averaging PLN260 million annually.

PKPIC's liquidity is very strong as result of the PLN1 billion equity injection. Due to the significantly lower capex in 2016 and 2017, the company accumulated cash and PLN1.5 billion was in its bank accounts at end-2017. We expect that the majority of cash will be absorbed by capex planned for 2018-2023. However, Fitch assumes that the company will still have adequate liquidity to service its obligations.

RATING SENSITIVITIES
Changes to the state's IDRs will be mirrored in PKPIC's IDRs, assuming that the links between the sovereign and the company remain strong. Loosening links between PKPIC and the sovereign could lead to a widening of the notching differential. Conversely explicit statutory guarantee issued by the state for all present or future liabilities of PKPIC could lead to a narrowing of the notching differentiation.

Contact:
Primary Analyst
Dorota Dziedzic
Director
+48 22 338 62 96
Fitch Polska S.A.

16 Krolewska Street
Warsaw 00-103

Secondary Analyst
Maurycy Michalski
Director
+48 22 330 67 01

Committee Chairperson
Guilhem Costes
Senior Director
+34 93 32 38 410

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549, Email:
athos.larkou@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria
Government-Related Entities Rating Criteria (pub. 07 Feb 2018)
(https://www.fitchratings.com/site/re/10019302)
National Scale Ratings Criteria (pub. 07 Mar 2017)
(https://www.fitchratings.com/site/re/895106)
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
(https://www.fitchratings.com/site/re/10020113)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
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